

How to build a team of 'appropriately skeptical' financial statement auditors

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A new study identifies the characteristics that make auditing professionals more likely to reward skepticism in the people they supervise, which is associated with an increased likelihood of identifying potential fraud during the auditing process. One key takeaway is that encouraging appropriate skepticism in auditors is closely tied to the culture of the workplace, offering valuable insights to firms that want to

encourage rigorous audits.

"Auditors need to be skeptical of the financial statements being provided by their clients, because skepticism is essential for detecting fraud and protecting the investing public," says Joe Brazel, corresponding author of a paper on the study and the Jenkins Distinguished Professor of Accounting in North Carolina State University's Poole College of Management.

"However, recent research suggests audit supervisors often punish staff for exercising skepticism that does not identify a misstatement—or fraud," Brazel says. "This presents auditors with an ethical conflict between acting in their own self-interest and acting in a way that improves audit quality and protects the public.

"That research also indicates that supervisors who reward appropriate skeptical behavior, regardless of whether the behavior identifies a misstatement in the financials, appear to develop staff that are more likely to detect and convey fraud red flags to their superiors.

"The question we wanted to address with this work was: who are the supervisors who reward appropriate skeptical behavior, regardless of the outcome? What distinguishes them from supervisors who don't reward skeptical behavior?"

For the study, researchers recruited 127 practicing auditors with 3–10 years of experience and who are tasked with evaluating the performance of junior auditors.

Study participants were asked to review a hypothetical case in which a junior auditor accurately identified a fraud red flag in the client's [financial statements](#), but in which the pursuant investigation found there was a reasonable explanation for the red flag—there was no fraud. The

study participants were then asked to give a performance evaluation of the junior auditor who reported and appropriately investigated the red flag.

Following completion of the performance evaluation, study participants completed a detailed survey designed to capture their personality traits, training, work history and [personal experiences](#) in relation to exhibiting skepticism while conducting audits. The work is [published](#) in the *Journal of Business Ethics*.

"We looked at 19 potential variables we thought may be related to a supervisor's willingness to reward skepticism," Brazel says. "We found three that are strongly associated with rewarding appropriate skeptical behavior."

The first variable was the ability to suspend judgment.

"This is one component of the trait of skepticism," Brazel says. "It's associated with people who are willing to follow the evidence to see where it goes, rather than jumping to conclusions. In this context, it tells us these people are supervisors who understand that not every red flag is associated with fraud. You are likely going to have multiple [false positives](#)—red flag investigations that have innocent explanations—for every investigation that identifies [fraud](#)."

The other two variables were both related to workplace culture.

"We observed that auditors who had been rewarded for exhibiting skepticism were more willing to pay it forward, and reward [skepticism](#) among junior auditors on their staff," Brazel says. "We also found that auditors who had experienced a culture of consultation, meaning they had worked in an environment that encouraged questions and engagement between junior and senior [auditors](#), were also more likely to

reward appropriate skeptical behavior.

"Our findings underscore the importance of workplace culture and identify characteristics that audit firms may want to cultivate in their staff and take into consideration when recruiting," Brazel says.

More information: Joseph F. Brazel et al, Who Rewards Appropriate Levels of Professional Skepticism?, *Journal of Business Ethics* (2024).
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